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**COUNTY OF LOS ANGELES  
DEPARTMENT OF AUDITOR-CONTROLLER**

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July 6, 2015

TO: Supervisor Michael D. Antonovich, Mayor  
Supervisor Hilda L. Solis  
Supervisor Mark Ridley-Thomas  
Supervisor Sheila Kuehl  
Supervisor Don Knabe

FROM: John Naimo  
Auditor-Controller

SUBJECT: **MARTIN LUTHER KING, JR. – LOS ANGELES HEALTHCARE  
CORPORATION LEASE AGREEMENT FUNDING REVIEW**

In April 2014, the County entered into a lease agreement (Lease) with Martin Luther King, Jr. – Los Angeles Healthcare Corporation (MLK) to operate a hospital on the Martin Luther King, Jr. Medical Center campus. The Lease includes approximately \$171 million in County financial assistance (i.e., grants and loans) to subsidize startup and operating costs. In accordance with the Lease, MLK is required to annually report to the County how the financial assistance was used.

We reviewed MLK's expenditures through June 30, 2014 to ensure that MLK accounted for, and expended, County financial assistance in accordance with the Lease. We also reviewed a sample of purchases (e.g., contracted services, equipment, etc.) made with County funding to assess internal controls and verify that MLK received the items they purchased.

**COUNTY FINANCIAL ASSISTANCE**

MLK expended \$48.6 million (61%) of the \$80.3 million in County financial assistance received as of June 30, 2014, leaving a remaining balance of \$31.7 million. The County had also committed \$90.8 million in financial assistance to MLK that had not been paid. A summary of County financial assistance commitments, payments, and expenditures is included in Attachment I.

We also included a detailed list of MLK's startup grant funding expenditures in Attachment II. We did not provide a detailed list of expenditures for other types of financial assistance (i.e., long-term loan, equipment grant, etc.) because most of the expenditures were for medical and information technology equipment.

### **EXPENDITURES/INTERNAL CONTROLS**

We confirmed that MLK's reported expenditures were generally accurate, supported by appropriate documentation (e.g., invoices, packing slips, etc.), and consistent with the Lease. We also confirmed that MLK actually received the items they purchased (e.g., contracted services, equipment, etc.).

MLK has also established suitable internal controls over the procurement process. We reviewed MLK's purchasing, contracting, miscellaneous expenditure (e.g., travel, etc.), and accounts payable policies and noted that they appeared reasonable. For example, MLK requires requests for proposals for contracts over \$100,000 and formal scoring documents to evaluate the vendors. MLK also sets limits on travel and expense claim reimbursement (e.g., mid-level hotels, etc.). We reviewed MLK's purchases and noted that they complied with policies and did not identify any control weaknesses.

We also reviewed MLK's Fiscal Year 2013-14 audited financial statements and noted that the independent auditor issued an unqualified opinion, which indicates that MLK's financial records are fairly presented and in accordance with Generally Accepted Accounting Principles. MLK management indicated that they have not received any additional reports from regulatory agencies relating to their activities.

### **STAFFING**

Most of MLK's startup grant expenditures were related to interim management, staffing, and consulting services due to the limited number of MLK employees. MLK's current management team includes a combination of employees, permanent contractors, and interim contractors. A current organizational chart is included in Attachment III.

One of the permanent contractors (Executive Assistant) is transitioning to become a permanent MLK employee. However, after being given the option of becoming an employee or independent contractor, the Chief Financial Officer (CFO), Vice President - Business Development & Strategic Planning (V.P. Business and Planning), and Chief Operating & Nursing Officer (COO/CNO) all chose to provide their services as independent contractors. One of the independent contractors cited work schedule flexibility as a factor for serving as an independent contractor.

As a 501(c)(3) non-profit, MLK is not responsible for paying federal or State taxes, however, they are responsible for withholding payroll taxes from their employees and remitting the taxes to the Internal Revenue Service (IRS) and State Franchise Tax

Board (State). Independent contractors are solely responsible for remitting their income taxes to the IRS and State.

An employer's failure to remit employee payroll taxes can result in fines and penalties. The IRS recognizes that the distinction between employee and independent contractor can be difficult to discern, so they offer their assistance. Specifically, employers that file Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding with the IRS are given guidance on whether a worker is an employee or independent contractor for tax reporting purposes.

We encourage MLK to conduct an appropriate analysis to ensure that their CFO, V.P. Business and Planning, and COO/CNO meet IRS criteria of independent contractors.

### **COMPENSATION**

The Lease specifies that for employees hired after April 2014, MLK cannot use County financial assistance to compensate MLK executive management in excess of the compensation paid to County employees with comparable positions. MLK management confirmed that this compensation limit exists whether a worker is an employee or independent contractor. We evaluated compensation paid to MLK management and noted that MLK is in compliance with the Lease. However, the CFO and V.P. Business and Planning have the option to become permanent MLK employees once the hospital is operational. If they exercise their option to become MLK employees, their agreed upon compensation would exceed that of comparable County employees. MLK should ensure that County financial assistance is not used for the excess compensation if the contractors become MLK employees.

We thank MLK management and staff for their cooperation and assistance during our review. If you have any questions, please contact me, or your staff may contact Robert Smythe at (213) 253-0101.

JN:AB:RS

#### Attachments

c: Sachi A. Hamai, Interim Chief Executive Officer  
Mitchell H. Katz, M.D., Director, Department of Health Services  
Dr. Elaine Batchlor, Chief Executive Officer, MLK Community Hospital  
Public Information Office  
Audit Committee

**MARTIN LUTHER KING, JR. - LOS ANGELES HEALTHCARE CORPORATION  
FINANCIAL ASSISTANCE COMMITMENTS, PAYMENTS, AND EXPENDITURES SUMMARY  
(FROM INCEPTION THROUGH JUNE 30, 2014)**

	COUNTY COMMITTED FUNDING	COUNTY PAID FUNDING	MLK EXPENSES FY 2013-14	MLK EXPENSES PRIOR FYS	REMAINING PAID FUNDING	REMAINING COMMITTED FUNDING
<b>GRANT FUNDING:</b>						
Startup Costs <sup>[1]</sup>	\$ 50,000,000	\$ 40,000,000	\$ 16,824,026	\$ 18,653,413	\$ 4,522,561	\$ 10,000,000
Equipment Costs	24,000,000	24,000,000	1,831,692	-	22,168,308	-
Out-of-Pocket / Additional Costs	5,000,000	5,000,000	-	-	5,000,000	-
Cerner Electronic Health Record System <sup>[2]</sup>	10,081,445	3,538,589	3,538,589	-	-	6,542,856
<b>TOTAL GRANT FUNDING</b>	<b>\$ 89,081,445</b>	<b>\$ 72,538,589</b>	<b>\$ 22,194,307</b>	<b>\$ 18,653,413</b>	<b>\$ 31,690,869</b>	<b>\$ 16,542,856</b>
<b>LOANS:</b>						
Long-Term Loan	\$ 50,000,000	\$ 7,737,638	\$ 7,737,638	\$ -	\$ -	\$ 42,262,362
Revolving Line of Credit	20,000,000	-	-	-	-	20,000,000
Short-Term Loan	12,000,000	-	-	-	-	12,000,000
<b>TOTAL LOANS</b>	<b>\$ 82,000,000</b>	<b>\$ 7,737,638</b>	<b>\$ 7,737,638</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 74,262,362</b>
<b>TOTAL FINANCIAL ASSISTANCE</b>	<b>\$ 171,081,445</b>	<b>\$ 80,276,227</b>	<b>\$ 29,931,945</b>	<b>\$ 18,653,413</b>	<b>\$ 31,690,869</b>	<b>\$ 90,805,218</b>

<sup>[1]</sup> Detailed list of MLK's startup grant expenses is included in Attachment II.

<sup>[2]</sup> Payments made directly to vendor by Los Angeles County.

**MARTIN LUTHER KING, JR. - LOS ANGELES HEALTHCARE CORPORATION**  
**STARTUP GRANT FUNDING AND EXPENDITURES (CASH BASIS)**  
**(FROM INCEPTION THROUGH JUNE 30, 2014)**

**FUNDING SOURCES:**

Los Angeles County	\$ 40,000,000
Investment Income (e.g., interest, dividends, etc.)	<u>181,190</u>
<b>TOTAL FUNDING SOURCES</b>	<b>\$ 40,181,190</b>

**EXPENDITURES:****SALARIES AND EMPLOYEE BENEFITS**

Fiscal Year 2013-14	\$ 1,656,816
Prior Years	<u>546,844</u>
<b>TOTAL SALARIES AND EMPLOYEE BENEFITS</b>	<b>\$ 2,203,660</b>

**SERVICES AND SUPPLIES****Fiscal Year 2013-14**

General Interim Management <sup>[1]</sup>	\$ 3,490,372
Information Technology Interim Management and Consulting <sup>[2]</sup>	3,286,662
Miscellaneous Expenses (e.g., Insurance, Advertising, Supplies, etc.)	887,047
Contracted Staffing and Services <sup>[3]</sup>	877,409
Legal, Audit, Accounting, and Tax	969,885
General Consulting	<u>414,953</u>
<b>Total Services and Supplies (Fiscal Year 2013-14)</b>	<b>\$ 9,926,328</b>
<b>Prior Years</b>	<b><u>11,267,542</u></b>
<b>TOTAL SERVICES AND SUPPLIES</b>	<b>\$ 21,193,870</b>

**FIXED ASSETS****Fiscal Year 2013-14**

Capital Equipment (Medical)	\$ 894,690
Capital Equipment (Information Technology)	372,223
Facilities and Equipment Procurement / Commissioning	<u>3,973,969</u>
<b>Total Fixed Assets (Fiscal Year 2013-14)</b>	<b>\$ 5,240,882</b>
<b>Prior Years</b>	<b><u>7,020,217</u></b>
<b>TOTAL FIXED ASSETS</b>	<b>\$ 12,261,099</b>

**TOTAL EXPENDITURES****\$ 35,658,629****ENDING BALANCE****\$ 4,522,561**

[1] Over ten executive and senior management positions, including Chief Administrative Officer, Chief Financial Officer, Chief Medical Officer, Chief Nursing Officer, Controller, and Human Resources Director.

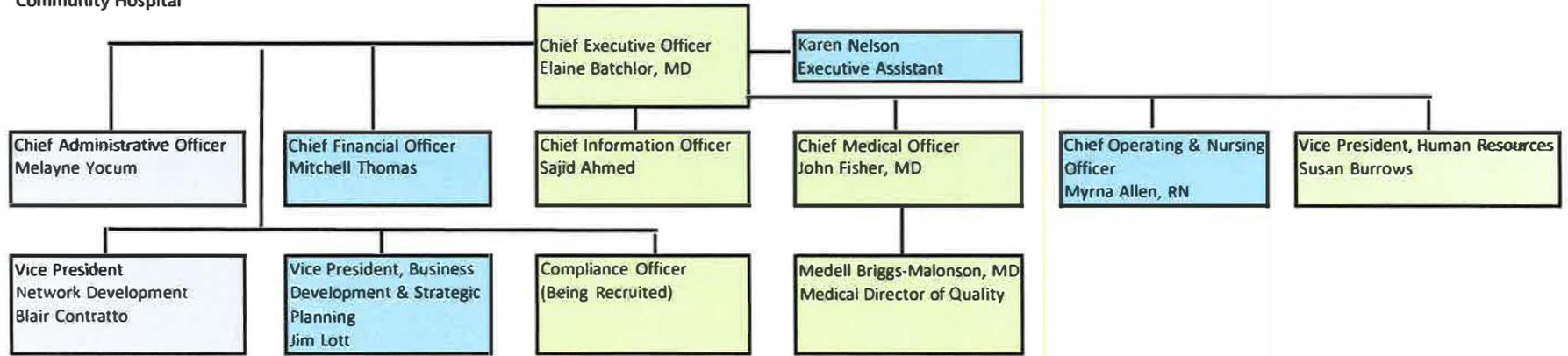
[2] Information Technology project management, systems implementation, and interim services and staffing.

[3] Non-management fiscal and administrative services and staffing (e.g., accounting, procurement, accounts payable, support services, etc.)



Martin Luther King, Jr.  
Community Hospital

**MARTIN LUTHER KING, JR. COMMUNITY HOSPITAL ORGANIZATION CHART**  
*as of March 19, 2015*



*Legend:*

- Permanent Positions (Employees)
- Permanent Positions (Contracted)
- Interim Positions (Contracted)

